No. 10494.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GENERAL INSURANCE COMPANY OF AMERICA, a corporation,

Appellant,

vs.

PATHFINDER PETROLEUM COMPANY, a corporation,

Appellee,

and

PATHFINDER PETROLEUM COMPANY, a corporation,

Cross-Appellant,

vs.

GENERAL INSURANCE COMPANY OF AMERICA, a corporation,

Cross-Appellee.

Brief of Appellee and Cross-Appellant Pathfinder Petroleum Company.

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Jurisdictional Statement.

Jurisdiction of the District Court over the cause is based upon diversity of citizenship and upon the fact that the

amount in controversy, exclusive of costs and interest, is in excess of $3000. (28 U. S. C. A., sec. 41.)

This Honorable Court has jurisdiction to review the judgment rendered by the District Court and to entertain the cross-appeal of Pathfinder Petroleum Company by reason of the provisions of 28 U. S. C. A., section 225.

Statement of the Case.

The appeal and cross-appeal involve the interpretation of a use and occupancy policy issued to plaintiff Pathfinder Petroleum Company.* By its terms [Tr. p. 13 *et seq.*] this policy insured plaintiff against loss occurring by reason of plaintiff's inability to use and occupy the premises in consequence of destruction by fire in so far as such loss represents

A. Net profits on the business which is prevented by reason of the destruction of the premises by fire, resulting in a total or partial suspension of the business of the insured.

B. The fixed charges and expenses to the extent to which they would have been earned had no fire occurred, and consisting of salaries of indispensable employees, superintendents, executive officers, employees under contract, taxes, interest, rents, royalties, insurance premiums, and other charges as listed in the policy. [Tr. p. 14.]

After the plaintiff had been engaged in the manufacture of gasoline products for approximately eight months, a

*The parties are referred to throughout as plaintiff and defendant.

fire occurred on August 31, 1940, by reason of which the manufacturing operations of the plaintiff were suspended for three months.

Following the fire, and pursuant to the provisions of the policy, an extensive preliminary proof of loss was filed with the defendant, covering at length and in detail the operations of plaintiff. It occupies in the printed transcript 48 pages of figures. The length and detail of this proof of loss and the laconic reply of the insurance company thereto [Tr. p. 114] become material in the consideration of plaintiff's Point I discussing the judgment for loss of profits, as rendered by the trial court, and also its contention that the claimed loss of fixed charges which would have been earned otherwise should not have been cut in half, as was done by the existing judgment.

Reduced to their shortest form, the questions on the appeal and cross-appeal are:

1. Under the terms of the policy, the proof of loss as rendered by plaintiff was such as to require the defendant under the provisions of the policy headed "Ascertainment of Amount of Loss" [Tr. p. 34] to make specific objections thereto. The purported reply of the insurance company to the proof of loss on page 114 of the record does not contain any specific objections. The amount of loss, therefore, became fixed at the figure shown in the preliminary proof of loss.

2. In arriving at the amount of net profits which would have been made by plaintiff had it not been for the fire,

the experience of the business for the full eight months preceding the fire during which plaintiff was operating should be considered.

3. The court should have allowed the full amount of fixed charges which plaintiff was prevented from earning, as given in the proof of loss, and as developed during the trial. Its action cutting said figure in half was error under the law and the evidence.

All the specifications of error contained in the transcript, as well as on pages 18 to 21 of the opening brief, are reducible in the final analysis to these three propositions.

We believe it will add to the clarity of the presentations if the facts pertinent to our various contentions are developed in connection with the treatment of each point. Since the pleadings have been adequately summarized in the opening brief, we proceed directly to the discussion of the three main questions listed above.

ARGUMENT.

I.

Plaintiff's Proof of Loss, in the Absence of Specific Objections Thereto, Fixed the Amount of Plaintiffs Loss at the Figures Therein Stated, Especially Since the Insurer Failed to Comply With the Provisions of the Policy (a) With Respect to Manifesting Partial or Total Disagreement With the Proof of Loss and (b) in Failing to Request an Appraisal.

(a) By Failure to Voice Specific Objections the Insurer Is Deemed to Have Assented to the Amounts Claimed in Proof of Loss.

As already pointed out, plaintiff filed an extensive proof of loss covering 48 pages. This proof of loss was the result of those provisions of the policy by which the insurer had the right to request that defects in the proof of loss be remedied by verified amendments. Under the terms of the policy these alleged defects were to be "specifically" stated by the insurer. [Tr. p. 33.] It was pursuant to this request for a specific statement of matters that plaintiff's voluminous proof of loss was prepared. [Tr. pp. 51-113.]

When this preliminary proof of loss is lodged with the insurer, the insurer, under the terms of the policy,

> "shall be deemed to have assented to the amount of the loss claimed by the insured in his preliminary proof of loss, unless within 20 days after the receipt thereof, or, if verified amendments have been re-

> quested, within twenty days after their receipt, or within twenty days after the receipt of an affidavit that the insured is unable to furnish such amendments, the Company shall notify the insured in writing of its partial or total disagreement with the amount of loss claimed by him and shall also notify him in writing of the amount of loss, if any, the Company admits on each of the different articles or properties set forth in the preliminary proof or amendments thereto." [Tr. p. 34.]

After having put plaintiff to the labor and expense of filing as detailed a proof of loss as the transcript reveals, defendant, in turn, did not trouble to comply in a similar spirit with the provisions of the policy. It merely sent a letter dated January 9, 1941, to the plaintiff in which it categorically stated:

> "The amount of loss which this company admits on each or all of the items specified in said preliminary proof of loss is nothing." [Tr. p. 114.]

Surely, if the insurer can require the proof of loss to be specific, the insured must have the reciprocal right to insist that the objections be specific. The insurer, therefore, should have specifically indicated which items of the detailed proof it agreed with and which items it disagreed with, rather than making a statement which amounted to nothing more than *a denial of its liability*. In other words, it is plaintiff's contention that it is entitled to a specific statement of disagreement from the insurer with respect to the amount of loss claimed on each specific item set forth in the proof of loss, and that the insurer does not fulfil that requirement of the policy by a mere categorical denial of liability.

That plaintiff had a right to something more than a mere denial of liability should be clear from the wording of the policy, and certainly is clear in the light of the case of *Lauman v. Concordia Fire Insurance Company of Milwaukee, Wisconsin,* 50 Cal. App. 609, 195 Pac. 951. In that case the plaintiff set forth in detail the items destroyed by fire, the cost, cash value, and the loss. Upon receipt of the proof of loss the defendant fire insurance company objected in the following language at page 620:

> "The aforesaid Concordia Fire Insurance Company disagrees with you as to the amount of the loss and damage claimed by you on any and all articles covered under the second item of the form as attached to the policy and described as 'merchandise' and does not admit that you sustained any loss or damage under this item by reason of said fire, as you have failed to show that the goods destroyed or damaged were your property or that you were liable by law for any loss or damage to said goods or that at any time prior to the date of the fire you had specifically assumed liability therefor, nor do you furnish any evidence as to your liability to others in the event said goods were held by you in trust at the time of the fire."

The court said, in reference to this objection:

> "The proof of loss set forth in detail the items paid by plaintiff to third parties; and if the insurance company intended to contest the amount of any particular item, it was required under the terms of the policy to specify the amount of loss it admitted on such items; otherwise it must be deemed to have assented to the *amount of the loss sustained on all items to which no specific objection was made. A general denial of all liability* would not meet the requirement of

its obligation under the policy to designate the different articles for which it disclaimed liability." (Italics by counsel.)

Plaintiff contends that the objection in the instant case is nothing more or less than a general denial and is not a specific objection to the individual items set forth in the proof of loss. The case of *Victoria Park Co. v. Continental Insurance Co. of New York,* reported in 39 Cal. App. at 347, 178 Pac. 724, lays down this rule:

> "The term of the policy which required the insurer to express its disagreement with the amount of the loss claimed within the specific time, otherwise it should be deemed to have assented thereto, was a binding condition of the contract. It meant exactly what it expressed or it meant nothing. It cannot be viewed in any sense as directory; the term is inapplicable to contract conditions entered into understandingly by the parties thereto which appear to be of material import as affecting the rights of the contractors."

While this particular case is somewhat different from the case at bar in the manner in which the defendant company objected to the proof of loss, nevertheless we suggest the rule is applicable to the instant case. In commenting on the objection the court stated as follows on page 350:

> "If the insurer had assumed in good faith that Watson and Barry possessed authority to negotiate for a settlement of the claims, it was put upon notice later by the service of the verified proof of loss as to what the amount of damage as asserted by plaintiff company was. At that time it should have, in keeping with the requirements of the contract of insurance, specifically announced its disagreement with the

amount of the claim in whole or in part and stated particularly what amount it did admit should be paid to the insured."

It seems perfectly logical that if the insurance company can, under the terms and conditions of the policy, force the insured to set forth in detail the amount of its loss and damage, the insurance company by the same token should be required to object specifically to each item set forth. Otherwise it is impossible to arrive at the true issues with respect to the amount of the loss and damage. To interpret this provision of the contract otherwise would be to place a burden on the insured and not a like burden on the insurance company. The insured is entitled to know which of the items, if any, the insurance company is objecting to in the proof of loss and the amount which the insurance company admits on each of the various items set forth in the proof of loss.

When the defendant contended that the plaintiff is not entitled to any portion of its loss, the only question before the court was that of liability or lack of liability under the policy. Once the trial court decided there was liability, the amount thereof was no longer subject to proof, because the defendant made no objection to any specific amount. When it rested on a denial of its liability, but made no other specific objections, it thereby waived inquiry into the correctness of the amount of loss claimed, once its liability was established. In Cooley's *Briefs on Insurance,* Vol. 7, page 6048, the general rule is laid down as follows:

"Under the principle that those defects upon which the company intends to rely must be pointed out, an objection to certain defects in the proofs will amount to a waiver of all of those not mentioned."

We respectfully submit that the defendant came belatedly before the court to contest the various items of loss set forth in the proof submitted to it, for its general objection certainly cannot be construed as a specific objection to each item as set forth in that document.

The statement from the case of *Lauman v. Concordia Insurance Co., supra,* which appears in italics in our previous quotation from it, was strictly speaking, not necessary for the decision in that case. Whether it is, nevertheless, sound law, is the question before this Honorable Court. Therefore it represents, in connection with this appeal, a matter of first impression. That it is of tremendous importance to the insurance business is obvious.

The reason why the language and reasoning of the cases to which we have referred on this point is sound may be readily seen in connection with this particular case. It would be entirely useless and would serve no purpose if, after an insured has gone to the trouble of specifically stating each item of loss, the insurer could then dispose of such a specific instrument by a general denial of liability. It is the apparent purpose of the provisions in question to clearly bring out the points of disagreement between the insurer and the insured, to determine as nearly as may be done the precise questions in dispute, and to reach at an early date an agreement as to all items concerning which there is no difference of opinion. That purpose is frustrated if the insurer is permitted to make a general denial of liability, and if he is then allowed, after his liability is established, to attack each item of the specific proof of loss separately, although he has made no specific objection thereto. According to the cases the legal rule should be that if the insurer denies liability, and if it should later be established judicially that he is liable under the policy,

he will not then be allowed to introduce evidence to vary, contradict, or attack the specific items of a proof of loss on which he could have manifested specific disagreements long before a lawsuit was ever filed.

That such a practice is especially desirable in a use and occupancy policy, where the accuracy of the proof of loss depends largely on the degree in which the plaintiff possesses the gift of prophecy, is evident from this case without further elaboration.

In the light of the foregoing the court was entitled to find that the loss sustained by plaintiff under Item I was, in the absence of specific objections to the various items involved, the sum of $22,974.94, and by the same token *the trial judge should have found for the plaintiff on Item II of the policy in the sum of $14,697.27, instead of cutting this latter figure in half.*

This failure of the trial court to find for the plaintiff in the full amount of $14,697.27 on Item II under the policy is the subject of plaintiff's cross-appeal, and in the light of the authorities cited it would follow that if the judge was compelled to find for the plaintiff in the full amount under Item I, according to the proof of loss he was similarly compelled to find for the plaintiff in the full amount under Item II. We respectfully request this court to consider this argument in connection with the cross-appeal of the plaintiff. We will, however, later point out that as an alternative proposition in support of our cross-appeal the trial judge was wrong both under the law and the evidence in arbitrarily cutting the figure $14,697.27 on Item II in half, or to reduce it in any amount.

That this issue was squarely presented to the court appears from the transcript of the pretrial proceedings

[Tr. p. 172], as well as from the remarks of the trial judge at the close of plaintiff's case in chief [Tr. p. 330], where the court said:

> "I think the record should also show that at the pretrial hearing it was the contention of the plaintiff that his proof of loss as submitted was conclusive as to the loss. In other words, that the plaintiff was not required to introduce any further evidence and it was not subject to dispute by the defendant; and that was submitted to the Court on briefs and the Court ruled against the plaintiff's contention and held that the plaintiff would be placed upon his proof to establish his loss. I think the record should show that, so that when this record goes before the Circuit Court the Court's ruling on that issue may be properly before the Circuit for decision."

(b) By Failing to Request an Appraisal of the Amount of Loss the Insurer Waived His Right to Object to the Amount of Loss Claimed in the Proof of Loss.

The defendant should be held in default under the policy with respect to the method it pursued in connection with the proof of loss in still another respect. Attention of this court is called to the provisions of the policy appearing on page 19 of the transcript, in which it is stated:

> "It is a condition of this insurance that in case the insured and this Company are unable to agree as to the time necessary to rebuild, repair or replace the described property, and/or the value of the subject of this insurance, and/or the amount of loss thereon the same shall be determined by appraisal in the manner provided by this policy, the provisions of which policy shall govern in all matters pertaining to this insurance except as herein otherwise provided."

There is no contention whatever on the part of the defendant that the plant could have been restored in a shorter period of time than the plaintiff took therefor, but the crux of the entire litigation is the amount of damage sustained by the plaintiff on account of the loss of profits. Since defendant so violently and totally disagreed with plaintiff on this score, it was clearly required, under those portions of the policy which we have just quoted, to take the necessary steps to see that

> "the amount of loss thereon . . . *shall* be determined by appraisal in the manner provided by this policy." (Italics ours.) [Tr. p. 34.]

The record is silent as to any attempt on the part of the defendant to follow this provision of the policy, and the fact moreover is that no attempt whatsoever was made to comply with the provisions to which we have just referred. [Tr. p. 235.]

The provisions of the policy with respect to the method by which the appraisal is obtained are contained in the following language:

> "If the insured and this company fail to agree, in whole or in part, as to the amount of loss within ten days after such notification, this company shall forthwith demand in writing an appraisement of the loss or part of loss as to which there is disagreement and shall name a competent and disinterested appraiser. . . ." [Tr. p. 34.]

It will be seen from this language, as well as from the clause previously quoted, that the obtaining of an appraisal is made mandatory by the policy inasmuch as it is uniformly held that the word "shall" means or is synonymous with "must." Not only are the provisions manda-

tory, but they are unilateral, since the initiative to obtain an appraisal rests squarely on the shoulders of the insurance company.

It will, of course, be contended by the defendant, in accordance with its position at the time of the pretrial and trial, that these provisions for appraisal are contained in that portion of the policy which embodies the provisions of the standard fire insurance policy adopted by the legislature of the State of California, that these provisions apply, therefore, to fire insurance, but not to the use and occupancy policy to which they are attached.

That this contention is not tenable appears from the following provisions of the policy itself. It is stated in section 13 of the use and occupancy endorsement that the amount of the loss

> "shall be determined by an appraisal in the manner provided by this policy, the provisions of which policy shall govern in all matters pertaining to this insurance, except as herein otherwise provided."

On the first page of the use and occupancy form the following language is used:

> "Loss, if any, subject, however, to all the terms and conditions of this policy, payable to the insured."

When the use and occupancy form was attached to the standard form of fire insurance policy, the parties obviously must have meant that the document as thereafter constituted should be considered as one policy of insurance, and that all provisions of the entire instrument should form one contract.

This being so, it follows that none of its clauses may be deemed to be superfluous or useless. On the contrary,

it must have been the intention of the parties to consider the provisions of the standard form of fire insurance contract as a material part of the use and occupancy endorsement.

Defendant will further contend, as it did in connection with the pretrial of this cause, that the appraisal provisions of the policy are void and against public policy in that they divest the courts of jurisdiction. There are two conclusive answers to that. First, in California, where this contract was made, arbitration provisions are not against public policy as long as they are not absolute and do not constitute an agreement not to resort to litigation at all. Secondly, the appraisal provisions under consideration are not in the nature of arbitration provisions; they are the result of legislative enactment. (See *Cal. Ins. Code*, sec. 2071.)

The mechanics of adjustment, as provided by the policy, are simple and purposeful. The legislature had a definite end in view when it provided therefor in the standard form. All of them have one aim, to define and narrow the matters in dispute.

First: The insured must furnish a proof of loss.

Second: If that proof of loss is defective, the insurer may ask for verified amendments.

Third: Within a specified time after the amendments are furnished the insurer may file objections to the items contained in the proof of loss.

Fourth: As to those items of loss to which the insurer objects, he must "forthwith" ask an appraisal, so that only those items need be litigated on which there is an honest disagreement after the appraisal method has been exhausted.

Clearly, the legislature interceded to avoid the necessity on the part of the court of turning auditor and of deciding which of several conflicting sets of figures is based on the proper method of computation.

Defendant, by following none of these prescribed steps--yet admitting some loss under its own alternative theories —should not be allowed now to place the task of auditor in the lap of the trial court, but should be bound by the figures to which it did not specifically object.

The requirement of an adjustment of accounts by appraisal in the case of insurance losses has been repeatedly held in California to be a condition precedent to the bringing of an action on the policy. We refer to the following cases:

> "In the case at bar, by express provision of the policy, the defendant's stock and funds are made liable, 'subject always to the conditions and stipulations endorsed hereon,' etc. Referring to the conditions and stipulations which qualify the general promise to pay in case of loss, we find: The defendant was not bound to pay until the declaration or affirmation, account and evidence therein provided for, should be produced. That on proof of loss *and adjustment of accounts,* the company was bound to pay immediately, or, at its option, to rebuild; and that, in case of difference of opinion as to the *amount* of loss or damage, such difference should be submitted to the judgment of two disinterested and competent men, mutually chosen, etc.
>
> "We think the language of the stipulation brings this case within the principle laid down in the English case above referred to; that it is the clear meaning of the contract that if the amount of loss cannot otherwise be adjusted to the satisfaction of the parties, it shall be adjusted by the mode of arbitration

therein prescribed, and that until such adjustment, or a fair effort on the part of the insured to obtain it, no cause of action arose."

Sauselito L. & D. D. Co. v. The Commercial Union Assur. Co., 66 Cal. Rep. 253, at p. 258.

" 'It is further expressly covenanted by the parties hereto that no suit or action for the recovery of any claim by virtue of this policy shall be sustained in any court until after an award shall have been demanded and obtained, fixing the amount of such claim in the manner above provided.'

"The language of the stipulations brings the case within the principle of the case of *Old Sauselito Land & D. D. Co. v. Commercial Union A. Co.,* 66 Cal. 253, and of the cases there cited, on the authority of which the judgment and order in the present case must be reversed. Here, as it was in the Sauselito case, the clear meaning of the contract is, that if the amount of loss cannot otherwise be adjusted to the satisfaction of the parties, it shall be adjusted by the mode of arbitration therein prescribed, and that until such adjustment, or a fair effort on the part of the insured to obtain it, no cause of action arose."

Adams v. South British and Natl. Fire Ins. Cos. of New Zealand, 70 Cal. 198, at p. 201.

It is respectfully submitted, then, that the trial court was correct under the principles herein discussed to fix plaintiff's loss under Item I in the amount of $22,974.94, and that the judgment as to the first item should be affirmed and under our cross-appeal the judgment as to the second item should be reversed, with directions to the lower court to increase the total judgment by the sum of one-half of the second item, or $7,348.64.

II.

The Trial Court's Finding That the Plaintiff Sustained Damages in the Sum of $22,974.94 Is Sustained by the Evidence and in Reaching That Figure the Court Applied the Proper Measure of Damages Under Item I of the Use and Occupancy Policy.

The second point is concerned only with the propriety of the court's finding that under Item I of the use and occupancy policy plaintiff sustained a loss of $22,974.94.

Under Point I we have shown that, considering the legal principles applicable to plaintiff's detailed proof of loss and defendant's failure to object thereto specifically, this figure of $22,974.94 must be deemed to have been established. We shall show under this point that considering only the evidence and disregarding the matters discussed under Point I, a finding that plaintiff was damaged under Item I of the policy in the sum of $22,974.94 is proper and fully supported by the record.

Item I of the policy reads:

> ". . . This company shall be liable under this policy for the actual loss sustained by reason of such suspension, consisting of:
>
> 1. The net profits on the business which is thereby prevented."

To arrive at this figure of loss, the policy lays down the measuring stick [Tr. p. 16]:

> "In determining the amount of net profits . . . for the purpose of ascertaining the amount of loss sustained . . . due consideration shall be given to the experience of the business before the fire and the probable experience thereafter."

It is obvious that some measure of prophecy or speculation is required on the part of the finder of facts to determine the amount of loss, and that it is not ascertainable by any formula of exact mathematical computation prescribed in the terms of the policy. As the trial court so aptly put it in its memorandum opinion, it was required to determine "what would have happened if nothing had happened."

In conformity with the above quotations from the policy, and basing the testimony on the previous earning records of the plaintiff company, plaintiff offers a simple method of computation. The average monthly earning record over the period of eight months prior to the fire—the total period of time during which plaintiff operated, being a newly founded concern—was arrived at by plaintiff's auditor and multiplied by three, representing the three months during which operations were suspended because of the fire. To that figure the auditor added 10 per cent, which he justified by pointing out that the volume of plaintiff's sales had increased constantly over the period of the preceding eight months, and that it was natural to expect that it would so continue to increase. In fact, when plaintiff, during the suspension period, purchased gasoline to fulfil its commitments and to prevent its sales organization and its good will from going into a slump, the company's experience showed an increase of sales during that period. To the figure thus established plaintiff's auditor added $3901.15, which he estimated to be plaintiff's loss of net profits on its polymerization unit which was under construction at the time of the fire. Concerning the propriety of including this figure in the loss sustained under Item I, we shall say more when we reply to appellant's special point devoted to this question.

This method of arriving at plaintiff's loss is natural, simple, in accordance with ordinary business experience, and certainly, as the trial court found, in accordance with the intention of the parties. As his memorandum denying a new trial says, this interpretation is "in conformity with the terms of the policy." The trial court not only adopted this method of calculation as being the one contemplated by the policy and by the intention of the contracting parties, but in connection with it he also accepted the figures of plaintiff's auditor on the loss under Item I as they were reflected both in the preliminary proof of loss [especially Tr. pp. 66 and 67] and later on in the auditor's testimony, which we shall not summarize in detail.

In view of its role as finder of facts, the court had the unquestioned duty to choose between the views of rival experts as well as between conflicting bases of adjustment. (*Hutchings v. Caledonia Fire Ins. Co.,* 52 F. (2d) 744.) His choice, according to well-established principles of appellate review, should not be upset unless there is no evidence whatever to sustain it. It would not be particularly charitable to defendant's expert to discuss at length the weaknesses of his testimony or to point out the arbitrary manner in which he eliminated obviously proper items from plaintiff's preliminary proof of loss. His cross-examination, however, makes interesting reading and shows that the trial court was fully justified in discrediting his testimony. [See especially Tr. pp. 363-371.]

Defendant's argument consists of a detailed re-examination of plaintiff's proof of loss. The argument in substance is that had the court taken any one of nine methods of calculation of which six are not based upon the previous earning record of the company over the period of eight months, the judgment would have been, depending

upon what method was adopted, either for the defendant or the sum awarded to the plaintiff would have been much smaller.

This argument could be considered only if the policy required as a matter of law, the adoption, as a basis of calculation, of some other criterion than the entire previous earning records of the company. This, however, we have seen, is not the case.

We shall not follow or analyze these nine alternative methods of defendant in detail. They constitute, however, one-half of its brief, extending from pages 34 to 65, the other half being taken up largely with a summary of the issues and preliminary matters. Some of these nine alternative ways, as we shall see, would allow plaintiff some damage, others would not allow the plaintiff any recovery.

What shall we say, then, of an insurance policy of which the one responsible for its language contends that *on the basis of one set of figures* furnished by the plaintiff it is susceptible in addition to the interpretation thereof furnished by the plaintiff *to nine different alternative* interpretations, or to nine different bases of figuring the loss? Or what shall we say of a defendant who maintains, after reading a policy subject to that many interpretations, that the court should choose precisely that interpretation which does not permit the plaintiff any recovery? Obviously, the law applicable to a policy of so confused a character is that the policy must be interpreted in the light most favorable to the assured.

> "It is to be remembered that contracts of this sort are to be interpreted in the light of the fact that they are drawn by insurance companies and are rarely, if

ever, understood by the people who pay the premiums. Every rational indulgence must be shown the assured."

Coniglio v. The Conn. Fire Ins. Co., 180 Cal. 596, at 599.

"Use and occupancy as terms of insurance may assume within their general scope the expectation of profits and earnings derivable from property; but the terms appear to have a broader significance as the subject of insurance and to apply to the status of the property and its continued availability to the owner for any purpose he may be able to devote it to. The defendant might have avoided all questions of contention and have made plain the subject of its insurance, if it were the business of the plaintiff, or its earnings and profits by the use of appropriate and unmistakable words, but such words occur nowhere. The defendant has chosen to make a contract of insurance which distinguishes its subject as something other than a building or machinery and which may mean the earnings of profits only by resorting to reasoning. The terms made use of have not the accepted significance contended for by the appellant and any doubt or ambiguity should be resolved against it and in favor of the assured."

Michael v. The Prussian Natl. Ins. Co., 171 N. Y. Rep. 25, at 35.

Let us, then, briefly reply to each of the nine methods of computation of plaintiff's loss which defendant suggests.

A.

Defendant's first alternative method is as follows: It says, We will grant plaintiff's figures and its earning record for eight months prior to the fire, but these figures do not take into consideration any depreciation for the previous eight months, whereas such is required in a use and occupancy policy under the case of *Fidelity Phoenix Ins. Co. v. Benedict Coal Corp.* (C. C. A. 4), 64 Fed. (2d) 347.

In this connection defendant makes reference on page 36 of its brief to a depreciation of $3034.93, but does not make clear the fact that plaintiff's proof of loss actually took into account that amount of depreciation. [Tr. p. 66.] Defendant says the amount of depreciation should have been the amount used by plaintiff in its income tax return, and the amount in the income tax return was $23,079.59. On the basis of such an allowance for depreciation, plaintiff would have made only an anticipated profit during the three months of suspension of $14,706.57. There are three conclusive answers to this contention:

First, the trial court as the finder of facts was not compelled to consider the larger amount of depreciation as the true one.

Second, not only as the finder of facts was the court entitled to consider the smaller sum as the true amount of depreciation, but also on the basis of decided cases the figures given by plaintiff in its income tax return as depreciation were not binding upon the trial court. The

trial court considered this argument and in its memorandum opinion disposed of it in this fashion [Tr. pp. 135, 136]:

> "This is not a new argument and in at least two use and occupancy policy cases, the courts have held contrary to defendant's contention.
>
> "In Puget Sound Lumber Co. v. Mechanics' & Traders Ins. Co., 168 Wash. 47; 10 Pac. (2d) 568, the court said: 'In such an action as this, the question is, not in what account did the insured place certain items of receipt or disbursement, of depreciation, or of profit or loss, *for the purpose of computing any income tax* which might be due for the purpose of making a statement for its banker, but rather to what account should the respective items be allocated for the purpose of determining liability, if any, upon the policies sued upon.' (Italics supplied.)
>
> "In Fidelity-Phenix Ins. Co. v. Benedict Coal Corp., 64 Fed. (2d) 347, 352 (4th Circ.), cert. denied 289 U. S. 762, the following language is used: '* * * We think it clear that such *losses are to be determined in a practical way,* having regard to the experience of the business before the fire and its probable experience thereafter, *without being confined to the basis upon which books are kept for income tax purposes* or for dealings with stockholders.' (Italics supplied.)
>
> "Upon the foregoing authorities I hold that this court is not bound by the amount charged off by the plaintiff for income tax purposes."

Third, the case of *Fidelity-Phenix Insurance Company v. Benedict Coal Corp.* (C. C. A. 4), 64 Fed. (2d) 347, is not authority for defendant's contention that the amount

of depreciation shown in the income tax return must be considered in arriving at the true amount of loss. At page 353 of that opinion, to which defendant refers, the court merely says:

> "And we agree with the learned judge in his dealing with depreciation and depletion under the heading of fixed charges. Depreciation on property which has been destroyed is not to be allowed as a fixed charge, even though it must be considered in estimating profits which would have been earned if the business had gone on; for manifestly property which has been destroyed cannot depreciate."

Defendant's argument on this first alternative method, therefore, does not show that there was error in the method of dealing with depreciation which was adopted by the trial court.

B.

But defendant says, Let us not take the entire eight months of plaintiff's previous experience of the business into account. Let us take only the three months immediately preceding the fire, because during those three months there was a distinct change in the market. Plaintiff got less for his gasoline, and under that system of computation, without considering depreciation, plaintiff would have made only a total of $12,476.60 of profit. Whereas, taking into consideration the depreciation reflected in plaintiff's income tax return, plaintiff would have suffered a loss during that period.

We are not told why, under the policy, the experience of the last three months immediately preceding the fire should be used. If the defendant, being responsible for the drawing of the policy, should have desired to make the

last three months the basis, it would have been very simple for it to say, instead of, "Due consideration shall be given to the experience of the business before the fire," the following: "Due consideration shall be given to the experience of the business *three months* before the fire."

In this connection, defendant does not mention that the drop in the profits during the last three months was explained by the plaintiff to be due to irregularity in manufacture and to the installation of improvements requiring a suspension of refining operations for various periods of time, which improvements, however, were calculated to increase the output and the profit in the future. [Tr. p. 338.]

Nor is the argument that the sales price per gallon obtained by plaintiff indicates a smaller profit at all valid, because, as the trial judge also said, that argument does not take into consideration the cost of manufacturing.

Defendant, moreover, misinterprets Exhibit 7 [Tr. p. 124] when it suggests that during the suspension period the average cost of manufacture would have been the same as during the eight months immediately preceding the fire. Plaintiff's Exhibit 7 was a computation furnished for the benefit of the trial court, and in no way intends to give actual average cost of production during suspension. What the average cost of production would have been during the three months of suspension was not gone into during the trial. It is seen, then, that defendant's second alternative method of computing the loss is based on fallacious reasoning and the method itself is not based on the language of the policy.

C.

The next method defendant suggests is that what should be taken into account is the month immediately preceding and immediately following the fire.

The policy, as we have seen, says that the experience of the business "before the fire and the probable experience thereafter" should be considered. It does not say—and if the defendant had desired this result, it would have been easy to so provide—"due consideration shall be given to the experience of the business one month before and one month after the fire."

This method, defendant contends, shows the great disproportion of the average monthly profits during the suspension period as compared with August and December, since the average profits for the suspension period, as found by the court, are claimed to be nineteen times as great as the company's average profit for August and December, if the income tax depreciation is not taken into account; and if the income tax depreciation is taken into account, the discrepancy is still greater.

A better indirect argument for the fallacy of defendant's contention could not be made than what defendant itself has said in this connection. Would a reasonable business man buy a policy from an insurance company, the recovery of which would depend on the experience of just one month prior to and after the happening of the fire? If defendant contends that the fluctuation of nineteen times the profit of another month is unusual in the short experience of the plaintiff, it need look only at its own Appendix 1 where it appears—if we may be as arbitrary in our selection as the defendant—that the profit in May was thirty times as large as in August, and in February, March

and April approximately twenty times as great. Defendant's third method, therefore, is also entirely fallacious and in direct contravention of the policy as well as of the natural expectancy of a person purchasing the type of policy here involved.

D, E, F.

Defendant next tries a new attack, and says if the amount of loss is determined on the basis of the cost of gasoline to the plaintiff, it would have sustained a loss whether the eight months preceding the fire are taken as a basis, or the three months preceding the fire, or the month immediately preceding and immediately following the fire.

It is obvious that that proposition is utterly untenable, because the policy provides that in determining the loss the experience *of the business* shall be taken into consideration, *not the cost of manufacturing gasoline* to the plaintiff. Certainly, that cost of manufacturing is not the only source of loss to the plaintiff during a suspension during which he operates with a top-heavy sales organization. Here again defendant's computations are based on the average cost for eight months of all gasoline manufactured and purchased, which figure does not take into consideration, as the trial court points out and as we also pointed out previously, the fluctuation in the cost of raw materials and manufacturing. Neither of these three methods, therefore, is the proper one to be used in arriving at plaintiff's loss.

G, H, I.

The final method suggested by the defendant as the proper one is taking into account plaintiff's alleged actual experience after the fire. At least his heading would indi-

cate that method, although the tables which follow (O. Br. pp. 50, 54, 56, 57) do not carry out that scheme. This argument, in all its ramifications, becomes progressively more difficult to follow. It is built around the proposition that plaintiff sustained an admitted loss during the suspension period of $32,975.68, which loss results largely by reason of the plaintiff going into the open market to purchase sufficient gasoline to fulfil its commitments. Now, defendant argues, had plaintiff not purchased any gasoline but had it been able to manufacture the same during the suspension period, it would not have saved enough from the manufacture to convert the loss of $32,975.68 into a profit. Defendant further maintains that before as well as after the fire plaintiff purchased a percentage of its gasoline in the open market and used it in connection with its sales activities. Defendant then says that plaintiff could not have converted its actual losses for the suspension period into a profit, even if it had manufactured gasoline, and that is so whether we use the average percentage of manufactured gasoline for the three months immediately preceding the fire or whether we use the percentage of gasoline manufactured during August before and December after the fire or whether we use the percentage of gasoline manufactured only during December, or even though we use as a basis the percentage of gasoline manufactured by the plaintiff during all of the eight months preceding the fire.

The inescapable corollary of this argument is that plaintiff would have been smarter if it had utterly suspended its operations during the reconstruction period; or, in other words, that it had no business of going into the open market to purchase sufficient gasoline to fulfil its commitments.

The first error in defendant's assumptions is that defendant again misconstrues the meaning of Plaintiff's Exhibit 7. The average manufacturing cost for September, October and November, as given there, is the average of the previous eight months and does not take into consideration fluctuation in the price of raw materials, fluctuation in the price of labor, the expense of a top-heavy organization lying partly idle by reason of the fire, and many other factors. Had the plaintiff actually manufactured gasoline during September, October and November, the average manufacturing cost might have well turned out to be different than the one given in the exhibit, to wit, .04608 per gallon.

Moreover, defendant does not take into account the fact that had plaintiff been utterly idle during the suspension period, the loss would have been immeasurably greater than the actual operating loss sustained during the suspension period. [Tr. p. 212.] In fact, a cessation of business for a period of three months would probably have resulted in the ruination of the business and good will which plaintiff had built up in its products during the eight months of its existence.

Finally, the policy does not warrant the strained method of computation which defendant has adopted, but on the contrary demands in express terms that during the suspension period the insured must

> "make use of other property, if obtainable, if by so doing the amount of loss hereunder will be reduced, and in the event of the loss being so reduced such reduction shall be taken into account in arriving at the amount of loss hereunder" (paragraph 18),

and the policy further provides:

> "Nevertheless this company shall be liable for such expenses as may be incurred for the purpose of reducing any loss under this policy, not exceeding, however, the amount in which the loss is so reduced."

In accordance with these provisions defendant's adjusting representative, Mr. DeCamp, told plaintiff to proceed to purchase gasoline and attempt thereby to minimize the loss, if possible. The testimony to that effect is undisputed. [Tr. pp. 209-211.] Surely, plaintiff cannot now be penalized when it followed the explicit instructions of defendant.

Therefore, if the insured, not content to suffer a total loss of its business, goes out in an honest attempt and in compliance with the provisions of the policy, to minimize that loss, clearly it is utter fallacy on the part of the insurance company to maintain that had the plaintiff operated during the suspension period it would have sustained a loss anyway, and that therefore it should not be entitled to any recovery.

It follows that the only fair, reasonable and equitable method of ascertaining the loss, and the one contemplated by the policy, is the one which bases the amount of the loss upon the previous earning records of the company; not the earning records of a selected series of months, but upon the entire experience of the plaintiff during its eight months of existence.

III.

Plaintiff Was Entitled to Include in Its Computation of Loss, the Prospective Profits of the Polymerization Unit.

The last point of defendant's brief is devoted to a discussion of the $3901.15 prospective profit on account of the polymerization unit. This profit, defendant maintains, is not allowable. In support of its claim it relies on *Fidelity-Phenix Fire Insurance Co. v. Benedict Coal Co.*, 64 Fed. (2d) 347. In that case, defendant says, the insured had decided to close down operations in seam No. 10 of its mine. A fire, however, which broke out soon afterwards saved them the trouble of carrying out their intention. The insurance company argued that inasmuch as the seam would have ceased to operate anyway, even if no fire had occurred, the use and occupancy policy should not be deemed to include this loss. This contention was overruled by the trial court and by the Circuit Court of Appeals.

How the defendant, on the basis of this case, can argue that if you are entitled to compensation for the loss of profits from a structure which you intended to close anyway, it necessarily follows that you should not be compensated for loss from a contemplated structure, the opening of which was prevented by the fire, is difficult to see. By logic the opposite conclusion is required. If you can be compensated for the loss from a structure, even though you intended to close it, *you should be all the more compensated* for the loss of profits from a structure

which you could have opened had it not been for the fire. The *Fidelity* case is, in effect, authority for our contention. If the polymerization unit would have been erected and would have shown a profit, then plaintiff is entitled to be compensated for the loss of that anticipated profit. That is one of the risks insured against. Defendant could have defeated this claim of anticipated profits only by showing that the unit would not have been a profitable venture. This the defendant did not do. On the other hand, the examination of the president of the company, Mr. Devere, showed positively that the operation of the unit was profitable and that the amount set up in the proof of loss on account of possible profits is a reasonable amount for 55 days of the period of suspension [Tr. pp. 116, 201-203]—during which time the polymerization unit would have been in operation had it not been for the fire [Tr. p. 202]—and was based upon the experience of the company. [Tr. p. 203.]

We submit, therefore, that the figure of $3901.15 is justified by the evidence, and that the trial court properly took that amount into consideration in arriving at the total loss of plaintiff under Item I of the policy.

IV.

The Court Should Not Have Cut Plaintiff's Claimed Loss on Account of Fixed Charges in Half, and the Existing Judgment for Plaintiff Should be Increased by $7,348.63.

This point is concerned only with the propriety of the court's finding that under Item II of the use and occupancy policy the plaintiff did not sustain a loss of $14,-697. 27 but that half of that figure, to wit, $7348.64 is the proper amount of loss under this item.

Under point I we have shown that according to the legal principles applicable to plaintiff's detailed proof of loss and defendant's failure to object specifically thereto, the loss under Item II became definitely established at this sum of $14,697.27. We shall show under this point that independent of the argument under point I, the finding that plaintiff's damage under Item II was only $7348.64 is contrary to the evidence as well as the legal effect of the policy and that, consequently, plaintiff's contention on its cross-appeal should be sustained and that the judgment of the trial court should be increased by the sum of $7348.63.

Item II of the policy undertakes to compensate the plaintiff for

> "fixed charges and expenses, only to the extent to which they would have been earned had no fire occurred, as follows: Salaries of indispensable employees, superintendents, executives, and of employees under contract, taxes, interest, rents, royalties, insurance premiums, advertising, special contracts, dues, subscriptions, directors' fees, accounting expense, legal expenses and fees, all other fixed charges and expenses . . ." [Tr. pp. 13-14.]

Plaintiff's witnesses testified at length with respect to the amounts paid on account of Item II at the following places in the transcript [Tr. pp. 241*ff.*, 278*ff.*, 285*ff.*, 306*ff.*, 332*ff.*, and 371*ff.*].

Without troubling the court with a summary of this evidence, we shall state generally that the actual amount paid out on account of Item II were larger than the estimates thereof in the proof of loss. During the suspension period they amounted to $20,832.92. [See Tr. pp. 332-333.] The estimate thereof given in the preliminary proof of loss [p. 67] is considerably lower, amounting to $14,697.27. The individual items on which this total estimate of $14,697.27 is based, are listed following page 73 of the transcript, where they appear intermixed with other non-fixed expenditures.

The trial court was of the opinion—and there is evidence to support his view—that some of the indispensable employees of the refining unit were used during the suspension period in plaintiff's sales organization, which continued operating during the suspension period. It does not appear, nor would it be possible to say from the figures in the transcript, what employees of the refining unit were made use of in the sales organization, nor is there any testimony in the record by which the value of such services to the sales organization, whether full or part time, could be ascertained. In spite of that fact the trial judge was not warranted in cutting the fixed expenses under Item II in half. If it intended to do any cutting it would have been more equitable to cut the actual expenditures for fixed charges for the period of suspension in half which, as we just stated was $20,832.92, and not the estimated figure.

It was right, however, to disregard totally defendant's view and version of the fixed expenses. Under defendant's testimony these fixed expenses were, however, at least $5801.25 or, based on a different starting point of computation, as much as $6198.20. [Tr. p. 358.]

Defendant, by the way, offers no explanation why it did not admit as much in response to plaintiff's proof of loss. It had all the figures available and could have narrowed the issues by that much. It did not do so. This shows clearly the prejudicial nature of its conduct in making a general denial of all items of loss claimed by the plaintiff. The figures just given were just as available to the defendant at the time it wrote the letter denying liability [Tr. p. 114] as they were at the time of trial. These items defendant was bound in good faith, and in order to facilitate the adjudgment of the loss, to admit. But it did not do so.

But defendant's expert testimony was for good reasons rejected by the trial court. Its expert nevertheless admitted that depreciation constitutes a proper item of fixed charges. [Tr. pp. 368-369.] Therefore under defendant's own accounting views 3/8 of $23,079.59, or $8653.20, should have been added to the fixed charges under Item II. This would bring the total of Item II under defendant's own testimony, to at least $14,454.45. Plaintiff, of course, does not claim the benefit of this computation in connection with the fixed charges because it has already had the benefit of this figure by reason of not taking the full amount of depreciation into account in its computations of prospective profits under Item I of the policy. The propriety of disregarding large items of depreciation, it will be remembered, was explained in point II, subsection b of this brief.

While defendant, then, admitted that there were fixed charges in at least the sum of $5801.25 and possibly in the amount of $6198.20, defendant's expert William F. Maloney arrived at these figures by arbitrarily decimating the figures given in the schedules attached to plaintiff's proof of loss and in plaintiff's books. For instance, he arbitrarily eliminated the executive salary of Mr. Brownell from the fixed charges [Tr. p. 363], he eliminated the item for dues and subscriptions, for fixed overhead, for legal and professional services [Tr. p. 365], although the policy expressly provides for them. [Tr. p. 366.] He included no items for salaries for the men in the manufacturing plant, and no light or power expense [Tr. p. 368], so that defendant's testimony with respect to the proper amount of fixed overhead and charges is utterly worthless.

Was the trial judge right in concluding that since some of plaintiff's employees continued to serve in the sales unit he was entitled to cut Item II in half? Surely not!

It is admitted that during the suspension period plaintiff, in an attempt to minimize its loss, incurred an operating loss in excess of $32,000. In spite of the fact, then, that some of plaintiff's employees from the manufacturing plant may have been used partly in connection with the sales organization, the fact remains that the payment of these salaries in connection with the sales organization was nevertheless an entire loss to the plaintiff. It did not even earn its fixed charges during that time, although it did precisely what the policy and the adjuster required. Therefore no benefit accrued to the plaintiff by reason of its permitting some of its employees from the manufacturing end of the business to participate in the sales work. On the contrary, the benefit accrued to the insurance

company. Plaintiff could have permitted these few employees to be idle, thus increasing the operating loss that much more. Therefore, the court proceeded on the wrong premise when it assumed that it was entitled to cut the amount of loss under Item II in half. The theory of plaintiff in this respect is well expressed in the following statement by Mr. Penney on behalf of plaintiff during the trial [Tr. p. 245], as follows:

> "Your Honor, under the policy here, if we were earning that before and we attempted to carry on the business afterwards, and we didn't earn it in the sales or in the conduct of the business following the fire, then under the terms and conditions of the policy we are entitled to be reimbursed for that. For instance, if we have an organization here in which we are actually earning $15,000 a month and paying those employees, and this fire comes along and we attempt to minimize our loss and we don't actually make the salaries of those employees, under the terms and conditions of this policy we are entitled to reimbursement, because the only thing we are doing is trying to minimize our loss, but we are not to be penalized by virtue of the fact that we are attempting to minimize it."

It is respectfully submitted, therefore, that the plaintiff was entitled to a full allowance under the policy in Item II on account of overhead and fixed charges, and that the trial judge was in error in cutting that figure in half. The judgment on Item II should have been in the sum of $14,697.27.

V.

Reply to Defendant's Contention A. That the Complaint Fails to State a Cause of Action; B. That the Findings of Fact Do Not Support the Judgment; and C. That the Plaintiff Did Not Sustain the Burden of Proof.

A. The Complaint States a Cause of Action.

We submit that the complaint conforms to the rules of Civil procedure for the district courts of the United States, especially 8, subdivision *a*, which requires a "short and plain statement of the claim showing that the pleader is entitled to relief," and with subdivision e(1), "Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required."

Whatever defect, if any, the pleading may have, defendant does not deny that there is a finding by the trial court that the plaintiff sustained a "loss of profits." We have shown that this finding, along with all others, is amply supported by the evidence.

Therefore, the provisions of Rule 15, subdivision *b* apply, which say:

> "When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respect as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; *but failure so to amend does not affect the result of the trial of these issues.*" (Italics ours.)

The rule then provides a mechanism by which the pleadings may be amended *in the event there is a motion to that effect during the trial* that the evidence is not within the issues. No such motion appears anywhere in the record, and the outcome of the trial, if otherwise correct, cannot now be affected by defendant's technical contention.

B. The Findings of Fact Support the Judgment.

The findings of fact must be liberally construed in support of the judgment. We submit that the findings do not need to follow the wording of the policy verbatim and that the court's language which follows is a sufficient finding that there was a loss of profits [Tr. p. 145]:

> "The court finds that as a result of the fire of August 30, 1940, the loss to the plaintiff of profits which would have been earned amounted to $22,974.94; that the loss to the plaintiff of fixed charges and expenses which would have been earned amounted to $7,348.63, making a total loss of $30,323.57."

When this language is read in connection with paragraph V, in which it is said that the plaintiff was deprived of the use and occupancy of the property and its normal business suspended for a period of 91 days [Tr. p. 142], and when the findings of fact are read as a whole, it appears that they do support the judgment.

C. Plaintiff Did Sustain Its Burden of Proof.

It is unquestionably correct that the plaintiff had the burden of proof in this litigation, but after the lengthy discussion which we have already indulged in, we feel that it would be superrogation to try to point out again in detail that the preponderance of the evidence was clearly susceptible to the findings which the trial court placed on it.

We submit that it was clearly shown that the operation of the sales organization and of the manufacturing organigation were interdependent and that the sales organization was adversely affected by the fact that it could not be supplied with gasoline manufactured by the refining department.

There certainly is no requirement in the policy that the plaintiff had to show the probable experience of its business for twelve months immediately succeeding the fire. The fact is, and plaintiff's brief itself reflects it, that the experience of the business after the fire, at least for the month of December after the fire, was discussed. [Tr. p. 348.] Plaintiff's president pointed out that plaintiff's experience in December was not typical and that the operation of the reconstituted plant was beset with numerous difficulties which justified the trial court in not paying any greater attention to the experience of the business after the reopening of the plant than it did.

Conclusion.

In conclusion we respectfully urge this Honorable Court to affirm the trial court in its conclusion under Item I of the policy. It expressly found that the business of plaintiff was prevented by the fire would have resulted in a profit of $22,974.94 [Tr. p. 138], and this finding is amply supported by evidence.

But we urge the reversal of the trial court's action under Item II of the policy. Here plaintiff's recovery should be increased $7,348.63, and the total judgment should be $37,672.20 plus interest from March 11, 1941, at the legal rate.

Respectfully submitted,

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